**ERROLD F. MOODY JR.**
BSCE, LLB, MBA, PhD
2232 W. Ave 133rd
San Leandro, CA 94577
Phone & Fax 510 352-4127
Marina Office 510 357-1554
Cell Phone 510 459-7797

Author, No Nonsense Finance, McGraw Hill
Life and Disability Insurance Analyst 0626414
Master of Science in Financial Planning
Registered Investment Adviser
WWW.EFMoody.com
EFM@EFMoody.com

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July 25, 2005

Secretary Jonathan G. Katz
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number 4-502



Dear Mr. Katz,

I have reviewed the petition. More particularly, I have reviewed the comments of several of the replies. From Richard Skora, "It points out grave problems concerning NASD arbitrators' proficiency in the law as well as deficiencies in surrounding issues.".

"Let me preface my comments with some of my background so you can put my subsequent commentary into perspective. I have taught most security licensing preparation courses (6, 7, 22, 24, 26, 27, 63, etc.) for the past 14 years. I have taught the Certificate Program in Financial Planning for the University of California, employee investment and financial planning seminars for top 500 companies and have written extensively in the field. I also acted as a NASD arbitrator for several years and as a fee only financial planner for over 18 years. That said, my comments are as noted below. These issues were discussed personally with Mr. Paul Frohan, Senior Compliance Examiner at NASD District 1 and I indicated that they needed to be explored more fully.
Agents in the business are rarely taught anything of real world use through the licensing training (and I indicate so to them). For example, beta and unsystematic risk- two mainstays in a review of suitability- are so lightly touched upon as to be useless in subsequent discussions with a client. Correlation and asset allocation- also necessary to understand suitability- are essentially missed in the entirety. And since there has been no continuing education in the field till recently, agents are woefully unprepared to provide even the most rudimentary analysis of a client's needs. As further verification of that statement, I simply need to ask "what is the risk of investing in individual stocks and what is the obligation (by law) of the agent to the client in addressing that risk?".
Additionally, we have the further area of volatility/standard deviation and the absolute basic criteria of suitability and basic planning, the pyramid of investing. This must be taught someplace since one can "easily" recognize unsuitability if one violates this basic tenet of investing.
Within that context I find that the knowledge of arbitrators- my main focus of this letter since any changes in licensing training will take eons- know even less than agents about the risks and rewards of securities or investing. While some "officials" say that that is the duty of the attorneys prosecuting or defending a suit to provide the insight, I have not even yet found one attorney that properly understood diversification. And if you

don't know this, you don't know anything about securities."

The point is that the above paragraph is from a letter I sent to Mr. John Pinto, NASD Executive Offices regarding Arbitrator Knowledge and Education ***over 10 years ago***.

Or.....

"I am in receipt of the Report and must state that I find it incredulous that the powers to be have yet to acknowledge the significant lack of broker, attorney and arbitrator knowledge of security application. A mere statement that arbitrator training requires improvement with almost sole emphasis on the law misses the major reason for arbitrations- suitability. There is NO training at the broker level regarding security application for a client profile nor is there anything at the basic level for attorneys. Actually, there is patently little training on securities anyway in the licensing training requirements."

The point is that the above paragraph is from a letter I sent to David Ruder, Arbitration Policy Task Force, regarding Securities Arbitration Reform ***over 9 years ago***.

And now.....

I do understand the statements of Mr. Skora. He is quite correct in many areas. I can certainly attest to being blackballed by the industry since, as an industry arbitrator, I tended to side with the plaintiffs based on my knowledge. Well, that ended that. Subsequently I have acted as an expert witness. No matter the issue, I have not seen any increase in competency in arbitrations by any of the parties. Actually it has gotten worse due to the vast and everchanging arena of economic and securities application- certainly due to the Internet, day trading Dotcom, indexed and variable annuities and more. The body of law does not address any of this save for miscellaneous commentary based on conjecture and illogical rules of thumbs.

There has been no significant factual increase in broker training education- they still do not know what the correct definition of diversification is. That is ludicrous. And as much as the understanding of the law certainly is required, an understanding of the issues in securities application (suitability) must be taught. You cannot apply the law in a vacuum. In my experience, I have never found an attorney or arbitrators who knew what diversification was. (I have a law degree- there is nothing in the material that addresses securities, statistics or suitability in the real world.) In short, it is the height of folly and arrogance to try to apply law to issues where the attorneys, experts, claimants and defendants are effectively clueless to the true issues. If you do not know the fundamentals of investing, you have no business trying a case. You have no business as an arbitrator in hearing a case. Sure, arbitrators may want to "help". But bloodletting by doctors in the dark ages was supposed to help as well. Somewhere along the line, real life education of the fundamentals is mandatory.

And no one at the SEC- I submit in my own arrogance- has a clue either. For example, past president Arthur Levitt, in his book, Take on Wall Street, sophomorically defined diversification. He suggested the use of planners who are illegal. (I do not disparage Levitt's contributions- but if you do not understand the fundamentals of investing, you are a far distance from providing competent advice in securities and financial planning to the masses.) I doubt Pitt knows the fundamentals, nor Donaldson and so on. I doubt there is but one or two people at the SEC that knows what diversification, what the risk of loss in equities is over time, etc. If I found attorney nationally that knew it, I would be surprised. That's not necessarily a big conclusion because, most incredulously, no broker has been properly taught the fundamentals of risk EVER. Fact is, CFPs, while taught (generally) more than brokers via the series 7 license, are provided a risk commentary for their exam that misses 50% of the risk that clients' are taking. Effectively every B/D in the U.S. is incorrectly defining risk. The point being that at any given point in time, equity investors will have only 50% of the asset base they anticipated/was projected. (The verification is provided in the book on Investments by Bodie, Kane and Marcus, 1989, page 222, Appendix C, called "The Fallacy of Time Diversification".)

I note from the SEC's website, "The primary mission of the U.S. Securities and Exchange Commission (SEC) is to protect investors..... As more and more first-time investors turn to the markets to help secure their futures, pay for homes, and send children to college, these goals are more compelling than ever.

The world of investing is fascinating, complex, and can be very fruitful. But unlike the banking world, where deposits are guaranteed by the federal government, stocks, bonds and other securities can lose value. There are no guarantees. That's why investing should not be a spectator sport; indeed, the principal way for investors to protect the money they put into the securities markets is to do research and ask questions."

The problem is, no one does any research. Including the SEC, NASD, brokers, planners, attorneys and more. If so, everyone would know the true definition for diversification and it would be immediately conveyed to the consumer for their understanding and use. Everyone would know the statistical element of risk. But, I submit, not a person reading this letter knows either. That is an impossible situation. You cannot ask consumers to ask questions to those who do not have the answers. Unfortunately, many of those "experts" will still attempt to provide commentary and analysis. I repeat as nauseam, if you do not know diversification by the numbers, you do not have an understanding of securities or their applications. Therefore you cannot define risk. That is ludicrous.

Skora notes, "the NASD ill-conceived policies have several negative consequences. To begin with, different arbitrators will interpret "fair and equitable" differently." My comment- as well they should since the real life application of securities, risk, etc. is ***not*** a fact of law but of an individual situation coupled with a statistical and knowledgeable analysis. You cannot do an analysis without an understanding of the fundamentals of investing. But if you are able to grasp such fundamentals, the fair, equitable and suitable issues will become clearer and more concise.

Skora continues, "another negative consequence is that without the knowledge of the law, even arbitrators who think they are applying the law may in fact not be." The Petition rightly states, "Without that knowledge, rendering a fair and just arbitration decision becomes a farce" and the NASD's guidelines are"effectively, no guidelines and an excuse to foster and enable incompetence." Here I truly disagree with the petition per se. It is NOT knowledge of the law (some latitude taken) that is mandatory but a knowledge of securities application. The parties must understand the true elements of risk and reward BEFORE any attempt is made to apply the law. But it has not happened before and is not even close now.

The petition is valid but premature. Until the SEC and NASD take it upon themselves the education and knowledge of securities application, the attempt of applying an inadequate and imprecise law will not make a substantial difference to the process and none to the consumer that needs the protection.

All parties must understand the fundamentals of investing first. To do otherwise is a breach of fiduciary duty to the public.

Very Truly,

Errold F. Moody Jr.